

## **STRATEGIC INITIATIVES TO ACCELERATE INFRASTRUCTURE DEVELOPMENT IN INDONESIA<sup>\*)</sup>**

**by**  
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Excellencies, distinguished delegates, ladies and gentlemen:

It is a pleasure for me to be here today – and to extend to you all a warm welcome to Indonesia. On behalf of the Government of Indonesia and the National Development Planning Agency let me say how much I appreciate this opportunity to share with you our new vision for Indonesia and the important role infrastructure will play in achieving our goals for economic growth and poverty reduction.

The tsunami disaster taught us many things about our country, about our people. One thing that it has taught us is how connected we all are – within Indonesia, and indeed with the world – through this terrible tragedy. We are all vulnerable to such forces of nature and we appreciate the vast outpouring of support. Now we all need to build on this goodwill to help the people of Aceh and North Sumatra rebuild their lives and communities in a timely and cost effective manner. As we speak, my staff are working hard on the initial assessment of damage and reconstruction needs, to be presented at the CGI later this week.

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This same connectivity affects all our development efforts. With your help we can take Indonesia on the next step toward greater regional and international integration and the growth it will bring. Across the archipelago we need to bring people and markets closer and this is at the heart of our infrastructure strategy. The political transition is complete, the economic foundations are set, and the confidence is there. Indonesia is on the threshold of sustained high growth and infrastructure is the key.

## 1. The Medium-Term Plan

The critical role of infrastructure is also a theme of our medium-term plan, that will be published this week. This strategy, which is designed to convey the President's program for the next five years, represents a departure from the past:

- ⇒ **First** it is focused on thematic areas, such as improving the investment climate and accelerating infrastructure development.
- ⇒ **Second**, despite the tight timetable, it has been widely discussed with regional and international participants as well as our friends in the government and parliament in Jakarta.
- ⇒ **Finally**, it begins to lay out priorities and a policy agenda, which, by May, we will use for the annual action plan and budget preparation for 2006.

Economic growth in Indonesia is picking up. We see growth rising into the 7 percent range by the 2009 and averaging 6.6 percent over the next five years. This pick up will be driven by higher investment and exports.

At the same time the debt overhang that is the legacy of the crisis prevents an increase in debt financing. Greater infrastructure investment is critical for what it delivers in the way of growth directly and for the role it plays in reducing the costs to the economy. The World Bank has been involved in a number of surveys related to the investment climate and they consistently flag infrastructure as an area of concern.

To achieve the goal of 6-8 percent growth a year will require nearly 145 billion USD in infrastructure investments for the next 5 years, with the government responsible for 20-40% of this total. The rest will have to come from you, the private sector. I don't want to leave the impression that the only reason we want more private involvement is because we don't have the funds. That could not be further from the truth. In fact the more important reason is that the private sector can deliver services more efficiently, and reliably and at lower cost and price to the consumer. But what does it take to catalyze the private sector into playing a larger role in infrastructure provision? That will be the theme of my remarks today.

## **2. Our Vision: A Comprehensive Infrastructure Strategy**

In the last few years very little private investment has happened here. There have been many reasons, including concerns with the political and economic situation. But now that the political transition has been completed peacefully, and fiscal consolidation has been achieved, the main worry of investors has shifted to "policy predictability". Let's face it: investors want to make money. And they can only make money if they take risks. But they are only willing to take risks if they know what they are and they can price them in to their decisions. In an environment of unpredictable policy -- for example, with politicized tariffs -- these much needed risk takers are discouraged. They will go to other countries and sectors where risks are lower and returns are higher.

We plan to change that – we want to make infrastructure investments in Indonesia so secure and profitable that you will want to invest your pension funds in it. But, to do that, we need to convince you that we are all moving in the same direction. Infrastructure policies are not made in ministry or one department. Their success depends on coordinated and concerted effort from many departments at different levels of government. Our job (in BAPPENAS) is to ensure the policy directions are coordinated through a clear articulation of a national vision and constant monitoring of progress.

Our infrastructure strategy has three parts:

- ***First, we will make infrastructure investment more commercially viable.***

This will involve comprehensive policy actions in the power sector, transport and toll roads, water and sanitation, ports, and telecommunications.

- ***Second, we will focus own resources increasingly on sectors which are not commercially viable – such as rural roads and specific investments that help the poor and remote communities.*** Specifically, we will use infrastructure investments to fight poverty.

- ***Third, more immediately, we will actively bridge the gap between the public and private provision of infrastructure by supporting public-private partnerships in infrastructure services and by removing all bureaucratic bottlenecks which currently inhibit private sector involvement.***

To demonstrate our resolve, we have already moved aggressively in recent weeks to issue a number of regulations designed to ease restrictions and pave the way for greater private sector participation in infrastructure investment. And more action is planned.

### **3. Public Sector Reform and Investment**

Private investment in infrastructure can only flourish when public infrastructure is managed well – it is two sides of the same coin. So the public sector has to find ways to work more smartly in a rapidly changing political and economic environment. Today I will focus on ***three elements of the public sector reform agenda***: to improve the performance of public enterprises, local governments and the central government.

**1- Public enterprise reform.** We have had good results from ongoing efforts to commercialize, corporatize and privatize infrastructure services and to separate

responsibilities for policy formulation, regulation and ownership of public enterprises – we need to consolidate this work and expand it. The most important sector from the standpoint of pressing ahead with commercialization and corporatization is roads, where there are compelling arguments for the progressive introduction of a soundly based user-pays regime for infrastructure use and the establishment of a system of road funds and road boards. The Ministry of Public Works has already done considerable preparatory work in this area. There is scope in the near term for moving ahead with pilot schemes. A new road law has recently been passed.

At the regional level, there is a pressing need to corporatize the water utilities (PDAMs) and to improve the governance framework within which they operate. A new law on regional enterprises (BUMDs) is currently being drafted which will provide an opportunity to implement policies that will enable and require PDAMs to operate at arms length from DPRD and regional governments in a professional, transparent and fully accountable manner. An improved regulatory arrangement for water supply is also urgently needed to further support this effort.

**2- Decentralization.** Decentralization has irreversibly changed the manner in which Indonesia is governed, but further actions are needed to better define the responsibilities of the different levels of government, to improve the implementation of financial transfers from the center, to promote effective inter-region cooperation, to build the capacities of regional agencies, and to prevent imposition of inappropriate taxes and levies.

The Government has recognized the need better define roles and responsibilities of the different levels of government, including those related to infrastructure sectors. Law UU22/1999 has been amended and preparations are underway to replace a number of earlier sector laws, including those for roads, road traffic and transport, railways, ports and shipping, and civil aviation. As part of this process the role of provinces as autonomous regions could be expanded. This may include, for example, the functions related to the management of small ports and airports, and to planning activities in the power sector. The central government

and the provinces will have to take greater responsibility in ensuring the consistency of infrastructure service provision across the country as well.

There should also be an effort to increase the technical capacities of various local entities so they can better select and implement investments, and improve the quality of services to consumers. Central government support will be crucial, especially for local governments that have limited technical capacity and also lack adequate accountability. Partnerships with the private sector, through joint ventures, investments, or twinning arrangements can be useful for upgrading local capacity. Specialists that are currently based in central ministries can play a critical role in this process.

**3- Central government reform.** The task of the central government has changed dramatically over the last decade or so, with the reduction in its ability to directly manage infrastructure provision. While the state remains central to economic development, its role is increasingly that of partner, catalyst and facilitator for local governments and the private sector. In response, the government will review the roles and organization of individual sector ministries and rethink the arrangements for coordinating policy and strategic planning.

Democratization, globalization and other factors are also imposing relentless pressures for improved performance in the area of governance. This government is giving high priority to stamping out corruption in the civil service and setting the highest standards of transparency and integrity in its dealings with the private sector. We also expect the same from you in your dealings with our officials. It takes two to tango – and we are looking for like-minded dance partners.

#### **4. Key Elements of Sectoral Reform**

We have to acknowledge that there are major issues affecting our infrastructure sectors, and that we are not providing the best possible services our people deserve. We want to change that. My fellow ministers who will be speaking to you this afternoon will lay out the Government's vision for their sectors and

provide you with clear direction as to how we would like to proceed with reforms. Let me provide you with a small flavor as to what we see as the major issues in each sector.

*When it comes to the transport sector*, we all know how important basic road transport services are to increasing access to health, and education services and markets, which in turn is essential to reducing poverty. As an archipelago, Indonesia's transport sector extends beyond roads. Our ports and airports are our gateways to the world. With the rapid increase in trade, specially within the ASEAN region, they are in urgent need of expansion.

There is a significant back-log of investments that must be addressed very quickly. But we must move beyond "catch-up", and implement our vision of infrastructure for all, for our future. We want to invite the private sector to partner with us to address these challenges, and we are simplifying the regulatory procedures to make it easier for you to do so. Not only do we want your support in these efforts, but we want to ensure that they will be very sound investment opportunities for you as well. The government will also do our part by making it easier for you to invest.

*Perhaps even more critical is the power sector* – unless we can provide more power to meet the ever-increasing demand, very soon you will begin to see power outages in this country. The investments needs are greatest in the power sector, with an estimate of US\$30 billion over the next ten years. We are focused on attracting financing by carrying out much-needed sector reforms and improved policies. We need to optimize our energy mix so that we move away from our heavy dependence on oil and look towards greater utilization of natural gas and renewable energy. Indonesia has over 90 million people who do not have access to modern electricity, and this undermines our competitiveness and presents these people from partaking in the economic revival in the country. Two-third of those without electricity live in rural areas and many of them are poor. I think we have an obligation to serve them better, and we will work with local government and the private sector to come up with novel solutions. As you can see, your role

is big in the energy sector. Because of the recent annulment of the electricity law, we plan to issue an interim regulation that can serve as a basis for private participation in the sector. But, we also know that we have to manage the sector more efficiently. So, when a revised law is proposed, we will look to restructuring the sector so there will be a sharper focus on the core businesses. We also recognize that reform and restructuring of the power sector takes time, and therefore, plan to provide a clear vision and direction by developing an updated sector reform agenda (blue print).

*In the water and sanitation sector*, the situation needs to improve greatly. We know that only 17% of the people are connected to a regional water utility. This is not acceptable. We also know that 60% of the 307 water utilities are in default of their loans. This is not acceptable either. We need to take urgent action by reforming the regional water utilities including restructuring debt, corporatization, and actions to help improve the environment for private sector investments. This must be done under a comprehensive policy and legislative framework. In this decentralized environment, it is also important to be clear about responsibilities within the government. Finally, we can't expect you to invest your money in loss making ventures, so having predictable tariffs that can recover costs will be an important element of a revised water sector in Indonesia. Although sanitation is less likely to appeal to investors, it is nevertheless an important piece of the infrastructure puzzle because of the social and health benefits.

*The telecommunication sector* is a good example where competition has benefited users as well as investors. Mobile connections have been increasing at a solid pace, while the prices have been steadily declining. This is good for consumers. With ever expanding customer bases, the sector has also been good to private investors. Now, it is time to move to the next level of telecommunications in Indonesia, and the Government will play its role in facilitating this. We will work to foster greater competition, with adequate regulation, and provide tariff predictability. Our aim is to develop an effective policy and regulatory environment conducive for mobilizing large-scale private investments.



## **5. Immediate Steps to Encourage Private Participation**

Given that many of these proposed reforms will take some time to implement, the Government has outlined a number of immediate policy actions to move swiftly to ease some of the obstacles which limit great private sector involvement and provide greater clarity, security, and comfort to investors in the near-term. Let me just highlight some of the more important commitments and actions we plan to take over the next six months:

- All contractual commitments made by the Government of Indonesia to the private sector will be honored. The Ministry of Finance will consider extending partial guarantees for specific areas of priority infrastructure projects – after examining the rationale and evaluating the cost of such contingent liability on public finance.
- We will develop clearly articulated strategies and sectoral plans for enabling private investment – especially for power, roads and water. This will give private investors the clarity and certainty they need to manage risks in their investments.
- We will invite investors to participate in upcoming fast-track infrastructure investments – these 91 projects worth up to US\$22 billion have been carefully selected, are critically important for the economy and allow investors to make an adequate return. These transactions will be managed by a senior-level government committee that will ensure an efficient, fair, transparent, and rapid selection of suitable investors.
- We will issue the pending laws in Electricity, Mining, and Telecommunication, and follow-up with promulgating all outstanding implementing rules and regulations (IRRs) in order to provide a legal

basis and inform the private investors how sector laws will be applied in practice.

- We will develop a risk management framework for private investments in infrastructure that includes a clear policy for public support for private investments. The framework will enable the Government to address specific policy-based risks that may exist at a given time of a private infrastructure transaction, but can also be adjusted to reflect an improving investment climate as reforms begin to take hold. The Minister of Finance will elaborate on this plan later this morning.
- We will revise and issue KEPPRES 7, originally issued to establish some basic “rules of the game” for private participation in infrastructure but found inadequate in its application. Hence the need for immediate revision.
- We will develop an action plan for independent tariff setting mechanisms for power and toll roads, recognizing that tariffs should rely on competition wherever possible and should be regulated for all monopolistic segments of infrastructure. In order to convey greater certainty to investors, the Government will transfer pricing responsibilities to regulators or other independent forum should be considered.
- We will strengthen regulatory agencies by providing budget and staff to give them high autonomy and transparency in the regulators’ functioning, and also be provided with adequate human and financial resources to undertake its functions.
- We will enable local governments to invest in infrastructure – including immediate revision of KEPPRES 35, to streamline procedures for

dealing with loans that would finance projects with components in many regions and for integrating its on-granting channel with the budget.

Let me turn briefly to the Aceh and North-Sumatera post disaster management. We are dividing the task into three phases. First emergency, then rehabilitation, and finally reconstruction. These are not actually discrete phases but one fades into the other. Nevertheless for planning purposes we envision that the immediate humanitarian relief operation will last for 6 to 12 months and be dominated by emergency operations with the priority on evacuation, foods, medical, and shelter. The rehabilitation phase will begin shortly and will be the dominant activity 6 months from now and last for another year and one half. This phase should allow us to restore services to the minimum levels required. Finally, we expect that the full reconstruction, and therefore recovery will be a process taking at least five years. We ensure that rehabilitation and reconstruction efforts of the devastated communities start early in a well-planned, coordinated, and transparent manner.

The challenge at this point is to deal with more than six hundred thousand people who are homeless or badly affected by the disaster, including the provision of water, food and basic shelter while electricity, communications and transport are restored. Beyond that we have to begin the massive and complicated recovery effort, an effort that requires sensitivity to those so severely affected.

All the emergency relief efforts are coordinated and oversighted by the National Coordinating Board for Disaster Management (BAKORNAS) under Vice President Chairmanship. While the longer run rehabilitation and reconstruction effort has been assigned to the National Development Planning Agency (BAPPENAS). Finally the Coordinating Ministry for the Economy will focus on overall coordination as we restore economic activity in Aceh and North Sumatra.

This disaster has triggered the largest outpouring of donor assistance ever seen. While we wholeheartedly appreciate this assistance, it inevitably creates

coordination problems. The Government of Indonesia provides the widest possible access for international humanitarian assistance. We do not want to risk either the relief or reconstruction effort, thus BAKORNAS is coordinating donor support for the emergency relief and initial rehabilitation efforts. The subsequent rehabilitation and reconstruction phase, for which the planning is now also getting underway, will be led by the Government of Indonesia supported by donors such as the World Bank, the ADB, Japan, Australia and the US. Finally, we will prepare an assessment of the damage and a recovery strategy by the upcoming Consultative Group for Indonesia on January 19<sup>th</sup> and 20<sup>th</sup>.

Our effort will be guided by the following key principles. We don't want to just reestablish the devastated areas but rather improve the lives of the people based on a comprehensive and holistic design. As we do this we are committed to listening to the people and especially their feelings and aspirations. We will also mobilize various experts, including geological experts to rehabilitate and rebuild safe and sustainable communities for our future generation. To achieve this program we have established clear direction including, most importantly, on coordination between sectoral and regional programs at the national and local level. The government is mandated in our constitution to protect and provide for the widows and orphans left behind by the Tsunami and we will make special efforts to address their needs. Finally, this is a disaster of unprecedented dimensions, but it is important that we be even-handed in dealing with disasters in other regions, including the recent earthquakes at Aloi in Flores and Nabire in Papua.

We have established a joint center, including line ministries and donors to complete damage and needs assessment. We have asked the help of the major donors in this effort including through the provision of technical assistance. We anticipate that this plan will be the key instrument to coordinate overall reconstruction programs involving GOI and donors. The plan will focus on restoring people's livelihoods, and effective local administration, as well as public infrastructure and services and to rebuild the economy local and national.

## **6. Conclusion**

In conclusion, the challenges ahead are huge. We need to forge a new partnership: with the private sector, development agencies, local governments and communities. There is a lot to be done. But we are excited about the challenges ahead. Rest assured, we will work hard to earn your trust and confidence. In turn, we will look to your sustained support in our efforts to rebuild Indonesia's infrastructure – to bring our country together and connect us to the wider world.

Thank you.■

Jakarta, 17 January 2005

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Chairperson of BAPPENAS

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